



July 16, 2002

BY HAND

Mr. Howard M. Spinner
State Corporation Commission
Division of Energy Regulation
1300 East Main Street, Fourth Floor
Richmond, Virginia 23219

Re: Calculation of Market Prices for Electric Power

Dear Mr. Spinner:

Thank you for your letter of June 10, 2002 concerning review of the methods used to calculate projected market prices and wires charges under the Virginia Electric Utility Restructuring Act. As you know, Appalachian Power Company, d/b/a American Electric Power ("AEP" or "Company") filed its market price and wires charges calculations for 2003 in Case No. PUE-2001-00306 on July 1, 2002 under the provisions of the Commission's order of November 19, 2001 in that case. In that filing, AEP did not propose any conceptual changes to the market price and wires charges methodology used in 2002 and proposed only those changes in data sources made necessary by intervening events.

Nothing has changed that should lead the Commission to modify the concepts that it adopted for market price calculations in 2002. The only suggestion for such a change in your letter is "incorporating the value of generating capacity into the current method of market price determination." No such change is necessary because the market prices derived from the current methodology already reflect whatever value the market places on electric power, and the Company cannot sell displaced power for more than market price.

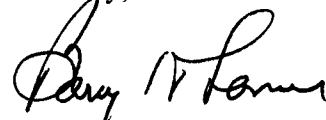
The Company disagrees if your letter is intended to suggest administratively determined adjustments to market prices. For example, one market price adjustment that has been suggested in the past is to add a margin to the wholesale prices used in the current methodology purportedly to convert the

wholesale price to a retail price. The concept is that certain retail costs of power marketers are not covered by the wholesale market price used in the Commission's market price methodology and must be added to it. For AEP this issue has been litigated, and there is no reason to revisit it now. In the Company's pilot program case, Case No. PUE-1998-00814, the Hearing Examiner found that a similar approach "which adds margins representing costs incurred by a CSP [competitive service provider], would send artificial signals and create unrealistic expectations for full retail access." Hearing Examiner's Report, p. 10, March 10, 2000. The Commission affirmed the Hearing Examiner's Report on this point without comment. The concept of such an adjustment is itself suspect, and those proposing such adjustments should carry a heavy burden to demonstrate that they do not artificially change market prices.

Section 56-583 A of the Restructuring Act requires adjustments to market price only for certain costs of transmission, transmission line losses and ancillary services experienced by an incumbent electric utility such as the Company. AEP has previously provided you with its interpretation of this provision and calculations of such adjustments to the market prices developed by the Company. The General Assembly has not provided for other adjustments to market prices, however.

As we have previously advised you by electronic mail on July 12, 2002, the Company intends to participate in the meeting scheduled for July 24 on this subject. The Company appreciates the opportunity to participate and looks forward to discussing these issues further with the Staff and the stakeholders.

Sincerely,

A handwritten signature in black ink, appearing to read "Barry L. Thomas", written over a horizontal line.

Barry L. Thomas, Director
Regulatory Services VA/TN